

Internal Revenue Service
memorandum

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to: Manager, Group 1113 IN:C:E:668
Assistant Commissioner (International)

from: Senior Technical Reviewer, Branch No. 1
Associate Chief Counsel (International)

Levinth Wood

subject: Taxpayer: [REDACTED] - Royalty vs Personal Service Income

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This is in response to your request for advice with regard to the characterization and tax treatment of income paid to a non-resident alien from music publishers and producers that sell his music in the United States.

ISSUE

Whether income paid to a non-resident alien by a United States publishing company for the right to copy and distribute musical works owned by a non-resident alien is royalty income, and thus income from sources within the United States subject to a tax of 30 percent.

FACTS

The taxpayer is a citizen and resident of [REDACTED] and did not spend more than 183 days in the United States during the years in question. He makes his living as a song writer and musical performer. It does not appear that the taxpayer is engaged in a trade or business in the United States, nor does he meet the physical presence test under I.R.C. § 7701(a). The taxpayer wholly owns a U.S. corporation, [REDACTED]. The taxpayer and [REDACTED] are currently under examination for tax years [REDACTED].

~~An unrelated United States publishing company paid~~
\$ [REDACTED] in [REDACTED] and \$ [REDACTED] in [REDACTED] to the taxpayer in his

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name. The payments were for the right to use [REDACTED] music that was sold on recordings produced by the publishing company. The contracts provide the United States publisher with the right to publish, distribute and commercially exploit the music. [REDACTED] music was written and recorded in [REDACTED]. The amounts paid are based on agreements entered into by [REDACTED] and the publisher. [REDACTED] reported \$[REDACTED] in [REDACTED] and \$[REDACTED] in [REDACTED] of the total payments as income. The remaining amounts (\$[REDACTED] in [REDACTED] and \$[REDACTED] in [REDACTED]) were reported as paid directly to the taxpayer. The taxpayer's basis and method of allocation for making this split is not clearly stated on the tax returns. The taxpayer reported the payments made directly to him as foreign source income on his Form 1040 NR. The taxpayer claims that these payments are the "writer's portion," as opposed to the publisher's share. The writer's portion is considered foreign source income by the taxpayer due to it being derived from personal services rendered outside the United States by a nonresident alien. This characterization of the payments as personal services performed in a foreign country allows the taxpayer to avoid U.S. income and withholding taxes.

These facts were confirmed by the taxpayer's representative in her August 25, 1994, letter that states the facts during [REDACTED] were as follows:

[REDACTED] writes a song in [REDACTED] (a [REDACTED] company) then acts as his publisher in [REDACTED] and submits for a copyright on the song in [REDACTED]. [REDACTED] then gives [REDACTED] the right to publish the song in the U.S. and throughout the world excluding [REDACTED].

The United States does not have an income tax treaty with [REDACTED]. If the payments are considered royalties paid to a non-resident alien, they would be subject to a 30% withholding rate.

DISCUSSION

The applicable taxing provision is I.R.C. § 871(a)(1)(A), which imposes a tax of 30 percent of the amount received from sources within the United States by a non-resident individual as interest, dividends, rents, salaries, wages, premiums, annuities, compensation, remunerations, emoluments, and other fixed or determinable annual or periodic gains, profits, and income. I.R.C. § 861(a)(4) provides that rentals or royalties for the use of or for the privilege of using copyrights in the United States are considered income from sources within the United States.

Alternatively, I.R.C. § 862(a)(3) provides that compensation for labor or personal services performed outside of the United States shall be treated as income from sources outside the United States.

Rev. Rul. 74-555, 1974-2 C.B. 202, holds that payments received by a non-resident author from a United States corporation under a contract granting the corporation rights to the author's literary works, but not prescribing what or when he is to write, are royalties from sources within the United States. An important factor in reaching this ~~determination is that the United States publisher only has~~ the right to the author's works, if he writes any new books. In addition, even if the author writes a book, the United States publisher only acquires limited rights, not the worldwide copyright and all of the rights associated with it. Another important factor is that the contract does not dictate to the author specific writing requirements. Accordingly, the ruling concludes that the arrangement is not an employment contract or contract for the rendition of personal services, but rather the transfer of the right to use the music in exchange for a royalty payment.

These same factors that cause the payments to the author to be a royalty in Rev. Rul. 74-555 are present in this case. The taxpayer does not have a contract with a United States music publisher that requires him to write music, nor does the publisher own the worldwide rights to the songs written by him. Thus, the United States music publisher acquires from the taxpayer limited rights to use the song in exchange for periodic payments. This arrangement is consistent with a licensing agreement, not an employment contract. Thus, under Rev. Rul. 74-555, all of the payments to the taxpayer are royalties sourced in the United States.

In Boulez v. Commissioner, 83 T.C. 584 (1984), the Tax Court analyzed, under the provisions of the United States - Germany Income Tax treaty, the character of payments made under a contract in which a conductor agreed to make master recordings for CBS Records. The Court established two tests for determining the nature of the payments:

(1) Did the petitioner (the conductor) intend and purport to license or convey to CBS records, and did the latter agree to pay for, a property interest in the recordings he was engaged to make, which would give rise to royalties?

(2) If so, did petitioner have a property interest in the recordings which he was capable of licensing or selling?

The Court concluded that the petitioner did not intend to convey a property interest to CBS Records since the contract was replete with language indicating that a contract for personal services was intended. For instance, the petitioner agreed not to perform services for others, with respect to similar recordings, for five years after the contractual periods. Moreover, the parties agreed that the recordings, once made, would be entirely the property of CBS. The contract contained no language indicating that the petitioner was conveying a pre-existing property right in the recordings to CBS, other than the designation of the petitioner's remuneration as "royalties". And, if the petitioner were unable to perform due to illness, injury, accident or refusal to work, CBS would be entitled to terminate its payments to him. Thus, the Court held that the petitioner intended to enter into a contract to provide personal services to CBS.

In contrast to the Boulez contract, the taxpayer's contractual arrangement shows an intention to convey a pre-existing property interest to the United States publisher. As noted above, the taxpayer wrote the songs prior to transferring any rights in the songs to the United States publisher. The United States publisher did not have any involvement in writing or producing the songs and did not acquire any interest in the songs until after the taxpayer wrote and produced the songs. In our opinion, a court evaluating the facts and applying the legal principles of Boulez would conclude the payments are royalties, not personal services income.


The taxpayer's representative's asserts that the payments are for services since the payments qualify as "earned income" under § I.R.C. 911. The taxpayer's representative concludes the taxpayer's situation is similar to the facts of Tobey v. Commissioner, 60 T.C. 227 (1973). In Tobey the Tax Court analyzed whether amounts received from the sale of paintings by a United States citizen residing abroad constituted earned income under I.R.C. § 911. The Court broadly interpreted the meaning of earned income which resulted in the Court concluding that income was derived from the painter's labor. We believe that the taxpayer's reliance on this case and I.R.C. § 911 is misplaced in the context of determining whether the amounts paid are royalties or personal services income. Whether the income received by the taxpayer would qualify for the earned income exclusion is clearly not at issue in this case. Moreover, even if we followed taxpayer's erroneous application, the Tobey case is distinguishable. In Tobey the painter transferred his entire interest in a tangible asset he made, whereas the taxpayer in this case transferred the right to use an intangible asset in a fixed geographic market. In our opinion, the taxpayer's

assertion that "earned income" under I.R.C. § 911 is equivalent to personal services income is not a logical conclusion.

In addition, taxpayer's representative asserts that Rev. Rul. 80-254, 1980-2 C.B. 222, which is based on the facts in Tobey, "updates" Rev. Rul. 74-555. This position is incorrect because Rev. Rul. 80-254 clarifies I.R.C. § 911 and Rev. Rul. 74-555 applies to I.R.C. § 861. Therefore, the taxpayer cannot rely on this analysis to reach his conclusion that any income that qualifies as earned income under I.R.C. § 911 is personal services income.

CONCLUSION

Our analysis of the facts and the applicable law concurs with your conclusion that Rev. Rul. 74-555 applies to this case. Therefore, we conclude that all of the amounts received under the contract should be characterized as U.S. source royalty income under section 861(a)(4). The taxpayer's assertion that a "writers portion" should be carved out of the royalty payment and characterized as personal services income is unsupported by the facts and inconsistent with the law in this area.

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If you have any questions or if we can be of further assistance in this matter, please contact E. Miller Williams at (202) 874-1490.